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No. 410

In the

Supreme Court of the United States

October Term, 1944

IN THE MATTER OF PROPOSED REORGANIZATION OF THE WESTERN TOOL & MANUFACTURING COMPANY, A CORPORATION,
Debtor,

OWEN N. PRICE, Trustee for Bondholders of The Western Tool & Manufacturing Co., and ROY MASSENA, E. J. PRICE, W. D. HOLLISTER and W. T. KETTERING, Bondholders' Protective Committee for Holders of Bonds of The Western Tool & Manufacturing Co.,
Petitioners,

vs.

JAMES G. GURNEY, Individually and on Behalf of Other Shareholders of The Western Tool & Manufacturing Co., and The Western Tool & Manufacturing Company, a Corporation,
Respondents.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

WM. W. KEIFER,
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GEORGE W. TEHAN,
Counsel for Petitioners.

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Supreme Court of the United States

October Term, 1944

No. .....

IN THE MATTER OF PROPOSED REORGANIZATION OF THE WESTERN TOOL & MANUFACTURING COMPANY, A CORPORATION,

Debtor,

OWEN N. PRICE, Trustee for Bondholders of The Western Tool & Manufacturing Co., and ROY MASSENA, E. J. PRICE, W. D. HOLLISTER and W. T. KETTERING, Bondholders' Protective Committee for Holders of Bonds of The Western Tool & Manufacturing Co.,

Petitioners,

VS.

JAMES G. GURNEY, Individually and on Behalf of Other Shareholders of The Western Tool & Manufacturing Co., and The Western Tool & Manufacturing Company, a Corporation,

Respondents.

PETITION FOR WRIT OF CERTIORARI

To the Honorable Supreme Court of the United States:

The Petition of Owen N. Price, Trustee for Bondholders under the Mortgage Deed of Trust of November 1, 1921, of The Western Tool & Manufacturing Co., and Roy Massena, E. J. Price, W. D. Hollister and W. T. Kettering, the Bondholders' Protective Committee for holders of said bonds of The Western Tool & Manufacturing Co. respectfully shows:

STATEMENT OF MATTER INVOLVED

1. The proceeding was begun in the District Court of the Southern District of Ohio, Western Division, at Dayton, by a Petition filed by James G. Gurney, (R. 1-4), professedly under Chapter X of the Bankruptcy Act, for reorganization of The Western Tool & Manufacturing Company, a corporation. It purports to be a Petition of the Company and it is signed, "The Western Tool & Manufacturing Co., by James G. Gurney." There was no authority from the Company for Gurney to file a Petition and none is claimed. The Petition does not disclose that Gurney had any connection with the Company nor any authority to sign or file the Petition for the Company. The Affidavit attached to the Petition, (R. 4-9) sets forth that James G. Gurney is a stockholder and was the agent and attorney-in-fact for certain other stockholders, though it is not stated that they joined in the Petition or that James G. Gurney acted for them in filing the Petition.

The Bondholders' Protective Committee filed a Motion (R. 13) to dismiss the Petition upon the grounds (1) that it was filed without authority of the corporation, (2) that it was unreasonable to expect that a reorganization could be effected since the only debts were the bonds which were all held by the Bondholders' Committee, and (3) that the Petition was not filed in good faith. A like Motion was filed by Owen N. Price, Trustee for the mortgage bondholders. (R. 63).

After a hearing the District Court, (Opinion, R. 90), sustained the Motion to dismiss the Petition for the reasons that stockholders had no authority to file a petition for reorganization of a corporation under Chapter X and did not come within the rule of *Hawes* v. *Oakland*, 104 U. S. 450. (R. 95).

2. Notice of Appeal was filed, (R. 97), in the name of The Western Tool & Manufacturing Co., signed by the attorneys for Gurney, professing to appear as attorneys for the Company. It appears from affidavits of the President and Secretary of the Company, (R. 109-110) attached to the Motion to dismiss the appeal, (R. 109), that no authority was given by the Company to give notice of appeal nor did the attorneys for Gurney have any authority to appear for it. This was not controverted. The Court of Appeals did not pass upon the Motion to dismiss the appeal.

3. The Circuit Court of Appeals for the Sixth Circuit reversed the judgment of the District Court, (Opinion, R. 112-124, Judgment, R. 112), and remanded for further proceedings, Presiding Judge Hicks dissenting, (R. 124).

QUESTIONS INVOLVED

4. The questions involved are whether a stockholder without authority from the corporation can file a petition under Chapter X of the Bankruptcy Act for reorganization of the corporation and whether the facts appearing in this record made a case for a stockholder to so act. The Circuit Court of Appeals held that the stockholder could so act.

JURISDICTION OF SUPREME COURT

5. This Court has jurisdiction to review the judgment of the Circuit Court of Appeals under Section 347(a) U. S. C. (Judicial Code Section 240(a)), this cause having been a civil case in the Circuit Court of Appeals.

The date of the Judgment to be reviewed is April 21, 1944, (R. 124); a Petition for Rehearing was filed May

10, 1944, (R. 125), (within the time provided for in the Rules of the Circuit Court of Appeals), and such Petition was denied June 1, 1944. (R. 135).

REASONS FOR ALLOWANCE OF WRIT.

6. The Petitioners say that there was error in the holding and judgment of the majority of the Circuit Court of Appeals in the following matters:

(a) In holding that a stockholder has the right under Chapter X of the Bankruptcy Act to file a petition for reorganization of the corporation.

(b) In holding that there was misconduct or wrongdoing on the part of the directors which authorized a stockholder to file a petition under Chapter X.

(c) In (apparently) holding that the corporation should have filed a petition for reorganization.

(d) In (apparently) holding that the corporation should have made defense in the suit for foreclosure.

(e) In not holding that the corporation was insolvent and that therefore the stockholder had no interest entitling him to initiate or participate in a proceeding for reorganization.

7. There are special and important reasons for granting the writ because the questions involved are of public and great general interest in this, that they are matters arising under Chapter X of interest to the business world and the courts and they have not been authoritatively passed upon by the courts.

The questions arise under a Federal statute and involve the meaning and interpretation thereof. They should therefore be determined and settled by the highest Federal tribunal. The holdings and opinion of the majority

of the Circuit Court of Appeals should not be allowed to stand as authority on these questions. That there is at least doubt as to the decision is shown by the fact that one Circuit Judge, (Judge Hicks,) dissented and agreed with the District Judge, thus two judges of the courts below are on each side of the questions decided.

Errors above referred to are considered in the brief hereto attached.

8. WHEREFORE, the Petitioners pray that a Writ of Certiorari may be issued by this Court to the United States Circuit Court of Appeals for the Sixth Circuit to review the judgment of that Court rendered in said cause April 21, 1944; that said judgment be reversed and for such other and further relief as may be proper.

OWEN N. PRICE, Trustee for Bondholders of The Western Tool & Manufacturing Co., and ROY MASSENA, E. J. PRICE, W. D. HOLLISTER and W. T. KETTERING, Bondholders' Protective Committee for Holders of Bonds of The Western Tool & Manufacturing Co.

Petitioners.

WM. W. KEIFER,
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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

Opinions of Court Below

The opinion of the majority in the Circuit Court of Appeals and the dissenting opinion of Judge Hicks are reported in Volume 142, Fed. 2nd, pp. 404, 411, and are found in the Record herein at pages 112-124.

II

Jurisdiction

This was a civil case in the Circuit Court of Appeals and the statutory provision which sustains the jurisdiction of this Court is Section 347(a) U. S. C., (Judicial Code, Section 240(a).

III

Statement of the Case

A statement of the proceedings in this case has already been given in the Petition herein in Paragraph 1 thereof. A statement of the facts under which this controversy arose is as follows:

The Western Tool & Manufacturing Company, a corporation under the laws of Ohio with its plant and business in Springfield, Ohio, found itself after the first World War heavily in debt. Consequently, in 1921, a bond issue of $100,000.00 secured by mortgage upon all its plant and property was authorized and $90,000.00 of the bonds were issued. In 1923 the interest on the bonds was in default.

It was apparent the bondholders might take steps to take over the property but to prevent this and keep alive the last lingering hope for the stockholders, control of the Company was put in the hands of the bondholders acting through Voting Trustees and the policy of the Company, according to the terms of the Agreement, (R. 76-80), was to be directed by the bondholders. This was an entirely natural and reasonable arrangement and was acted upon continuously without objection until the present controversy arose in 1942. At about the same time a Bondholders' Protective Agreement, (R. 80), was made and a committee was constituted in whose hands all of the bonds were deposited except $300.00 of same. (This $300.00 of bonds disappeared and evidently were lost for no claim has been made on them, and by decree of the Court in the foreclosure suit they were held barred by the statute of limitations.) Under that management the Company managed to keep alive, with interest on the bonds always long overdue. It was at one time the plan of the Bondholders' Protective Agreement to make some readjustment of the bonded indebtedness, but that was never carried out for reasons that do not appear and are, of course, not important here. Especially during the depression did the Company have financial difficulties but the bondholders through their representatives kept it alive with a faint hope on the part of some of those interested that it might at some time pay out. When more work for machine tool parts (which this Company was producing) became active during the present war the Company's business improved and it operated at a profit. However, the interest on the bonds was largely in arrears and it was apparent to those interested for the bondholders that the bonds would not be paid in full, and it also became apparent that the time had arrived to dispose of the plant and busi-

ness since none of the interested parties was actively engaged in operation of the plant and they resided at a distance from Springfield, Ohio, where the plant was located, most of them in the vicinity of Chicago.

At this time James G. Gurney, a member of the Board of Directors, although not a bondholder or representing bondholders, advocated a great expansion, going into debt for machinery and equipment with the idea of greatly expanding the business of the Company, his plan including his control of the Company and getting 10 per cent commission on sales, (R. 30), and the employment of Harlan T. Hyde, (R. 32), another stockholder. This plan did not appeal to the other directors. They had kept the Company out of debt, except the bonded indebtedness, and to accumulate debts that would be prior to the bonds they believed would be hazardous. As a result of these demands and threats by Gurney and his attorney a suit was brought by the Trustee for the bondholders in the Court of Common Pleas of Clark County, Ohio, July 9, 1942, for foreclosure of the mortgage and a receiver was appointed July 15, 1942, to have charge of the property and operate the business, since which time the receiver has actively operated the business. On account of this proceeding for reorganization no sale of the property has been made.

Complaint was made of the bringing of the foreclosure suit and of entering the decree, especially that the judgment was entered for interest at the rate specified in the mortgage, 8 per cent. It was complained that the Company should have made defense as to the rate of interest. That there was no haste or advantage taken of the stockholders in the foreclosure suit is shown by the fact that Mr. Gurney and his attorney were notified of the filing of the suit the day after it was filed and shown a copy of the Petition in that case. (R. 21). Shortly thereafter Mr.

Gurney was represented at Springfield, Ohio, by an attorney, John M. Cole, (R. 32), who was constantly informed of proceedings and contemplated proceedings in the case, including repeated notice that the Plaintiff would ask for a judgment and decree by default. (R. 38-9). Accordingly, after definite notice (R. 38-9) the Plaintiff applied for a decree in foreclosure and it was rendered December 8, 1942. (R. 59) No steps were taken by Gurney in the suit until after final judgment when a motion to set aside the judgment was made, which motion was overruled after the judgment in the District Court.

In the present proceeding Mr. Gurney claimed that the interest on the bonds should be 4 per cent. It was at one time contemplated that the interest be reduced to 6½ per cent, (Bondholders' Protective Agreement, R-82-3), and at another time there was a plan to reduce it to 4 per cent (R. 68), but there was no evidence that either plan was consummated. Gurney in his Petition, (R. 2), stated that after the payment of interest to November 1, 1929, the Committee agreed to accept interest at 4 per cent per annum but in the Affidavit filed with the Petition for reorganization, (R. 8), he said that the Bondholders' Committee agreed on or prior to July 20, 1923, to cause a refunding of the bond issue at 4 per cent but failed to do so. (As a matter of fact the payment of interest to November 1, 1929, was made long after that date, as all the interest payments were made after long overdue. (R. 46, 49).

There is no testimony of any agreement made to reduce the interest and the only scraps of testimony as to rate of interest are (1) a letter from E. J. Price to Judge Oxford at Lakeland, Florida, (R. 68), (who at that time represented Harlan T. Hyde), in which Mr. Price referred to "the plan of the Committee to reduce the unpaid interest rate to four per cent", and (2) the statement of E. J. Price, testi-

fied to by Mr. Gurney, (R. 31), that it had been agreed that the interest be reduced to 4 per cent but Mr. Price added that they did not have even enough money to pay that much. The fact is that the Committee accepted interest for a time at 6½ per cent and for another time at 6 per cent, (R. 2), thus negativing any agreement at 4 per cent.

Complaint was made that there was not a legal election of directors at the stockholders' meetings of 1941 and 1942 because (1) there was no quorum of three-fifths of the stockholders, and (2) one or two stockholders were not notified of the meetings. There was not the quorum required by the articles of incorporation at these meetings by reason of Gurney staying away, thus breaking the quorum. The stockholder not notified of the 1941 meeting was Mr. Gurney's mother, whom he had been regularly representing at former meetings and it was assumed that he would represent her at these meetings. The stockholders not notified of the 1942 meeting were Harlan T. Hyde and Gurney's mother. There is no claim that James G. Gurney and his father, James Gurney, Jr., were not notified. These irregularities in these meetings were not material for the control of the Company was in no way changed. The complaining stockholders were promptly notified of the holding and action of these meetings. (See letters, R. 74, 69, 74-5). If the 1940 board, by reason of failure to elect in 1941 and 1942, continued to be the legal board the same persons would have been in control, that is, the ones chosen by the representatives of the bondholders in accordance with the stockholders' agreement. But the boards chosen by the 1941 and 1942 meetings were de facto boards, recognized by everyone until this controversy arose and particularly by James G. Gurney in attending and participating in at least one meeting after a supposed invalid election. (R. 32, 48-9).

Complaint was made that the voting trust agreement was not terminated. Whether this should have been terminated is not material here. It plainly was to continue "pending the payment of said bonds", (R. 77), but the voting trust was not terminated and no attempt was made to terminate it by legal action.

It sufficiently characterizes the charges of this stockholder to point out that in his Affidavit, (R. 7-8), he charges that the directors caused the corporation to pay the Bondholders' Committee $16,000.00 on June 16, 1942, "and have not accounted therefor", while in the Petition, (R. 2), he alleges that the corporation paid the $16,000.00 on June 16, 1942, to the Bondholders' Committee "to be applied upon the indebtedness evidenced by the bonds." There was of course nothing wrongful in thus making a partial payment on an overdue debt.

IV

Specification of Errors

The Circuit Court of Appeals erred in holding:

(a) That a stockholder has the right under Chapter X of the Bankruptcy Act to file a petition for reorganization of the corporation.

(b) That there was misconduct or wrongdoing on the part of the directors which authorized a stockholder to file a petition under Chapter X.

(c) That the corporation should have filed a petition for reorganization.

(d) That the corporation should have made defense in the suit for foreclosure.

(e) That the corporation was not insolvent.

V.

Argument

(a) Stockholder has No Authority to File Petition Under Chapter X.

The section that governs the filing of a petition under Chapter X of the Bankruptcy Act is Section 126 of that Chapter (U. S. C. Title 11, Section 526) which provides:

> "A corporation, or three or more creditors who have claims against the corporation or its property amounting in the aggregate to $5000.00 or over, liquidated as to amount and not contingent as to liability, or an indenture trustee where the securities outstanding under the indenture are liquidated as to amount and not contingent as to liability, may, if no other petition by or against such corporation is pending under this chapter, file a petition under this chapter."

As if to make it clear, Section 106 of Chapter X (U. S. C. Title 11, Section 506) provides:

> "For the purpose of this chapter, unless inconsistent with the context—
>
> (1) 'claims' shall include all claims of whatever character against a debtor or its property, *except stock*, whether or not such claims are provable under Section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;
>
> . . . . . .
>
> (4) 'creditor' shall mean the holder of any claim;
>
> . . . . . .
>
> (9) 'petition' shall mean a petition filed under this chapter by a debtor, creditors, or indenture

trustee proposing that a plan of reorganization be effected;

. . . . . .

In the following cases stockholders attempted to file petitions under Chapter X on the theory that they should be considered creditors, and in each it was held that stockholders did not come within the statute above quoted as having a right to file a petition.

Bryan v. *Welch*, 74 Fed. 2nd, 964, syl. 4, (10 C. C. A.) certiorari denied 295 U. S. 748;
In re Picadilly Realty Co., 78 Fed. 2nd, 257, syl. 2, 3, 260-1 (7 C. C. A.);
In re Pittsburgh Terminal Coal Corp., 30 Fed. Sup. 106; affirmed 3rd C. C. A., 109 Fed. 2nd, 1020, on opinion of court below;
In re Phoenix Hotel Co., 13 Fed. Sup. 229, syl. 4, affirmed (6 C. C. A.) 83 Fed. 2nd 724;
In re Arcadia Furniture Co., 12 Fed. Sup. 477.

"As a stockholder of the bankrupt, appellant William H. Neblett was not and could not have been aggrieved by the order appealed from. As such stockholder, therefore, he has no interest or standing to prosecute this appeal."

In re Newport Corp., 98 Fed. 2nd, (9 C. C. A.) 453, 455-6.

(The above case is in point upon the motion of Appellees to dismiss the appeal in the Circuit Court of Appeals.)

Board of Directors Must Act to Authorize Such Petition
~~**Voting Trust is Valid**~~

Action by board of directors is necessary to authorize filing of petition by corporation under Chapter X.

10 *Remington on Bankruptcy*, (5th Ed.), Section 4434, p. 330.
White v. *Penelas Min. Co.*, 105 Fed. 2nd 726, syl. 2.

It is certainly not necessary to cite authorities that only directors can determine as to the action of a company when there is any reason for question or doubt, that is, when it is a matter of judgment as to what is best to do or when it is a matter of policy. That question as to the right and power of directors is settled in case of *Voeller* v. *Neilston Warehouse Co.*, 311 U. S. 531, which involved an Ohio corporation. This decision is directly to the effect that directors are chosen by the stockholders to act for them, that the corporation acts through them and the stockholders cannot intervene in the affairs of the corporation.

> "The majority are participants in a corporate enterprise. In entrusting their capital to the corporation, they accept the disadvantages of the corporate system along with its advantages. What is claimed to be a disadvantage here is a necessary concomitant of the system and its most distinct attribute—representation of the collective interest of shareholders by selected corporate management."
>
> 311 U. S. 536-7.

Counsel for respondent now admit that the statute does not provide for stockholders to file a petition, but assert the right of the stockholder to file the petition for other reasons, (which we will consider later). However, since the decision of the Circuit Court of Appeals is based apparently upon the theory that the stockholder can file the petition if the Court thinks the corporation should have

done so, the effect of this decision is that a stockholder may file the petition whenever the court thinks a petition should have been filed. Thus the statute would be disregarded. This not only usurps the province of the directors but gives a stockholder a right that the statute withholds — clearly judicial legislation. The Opinion argues stockholders should have the right to initiate a reorganization. This should be addressed to the legislative branch of the government.

The Opinion of the Circuit Court of Appeals recites at length that this dissatisfied stockholder alleged in the Petition or in his affidavit certain things claimed to indicate wrongdoing on the part of the directors. The record shows that no wrongdoing was proved and the Opinion nowhere refers to testimony to support the charges. Charging misconduct without proving it is hardly sufficient to entitle one or more stockholders to supplant the directors in the management and direction of the affairs of the corporation. The last words of the Opinion indicate that the majority had considered the "facts", but what facts are considered as proven does not appear. The District Court, the trial court, found no such proof, (R. 95). Thus we are entirely in the dark as to what, if any, factual ground was the basis of the decision of the Circuit Court of Appeals.

(It is worthy of note that the Opinion was amended after announcement by striking out some obviously mistaken statements, (R. 135), to which attention was called in the Petition for Rehearing. (R. 126-7). A further misstatement of fact in the Opinion, (R. 116), was the statement that Gurney had alleged that the board notified the stockholders that no action would be taken to initiate the reorganization proceeding. No such statement or claim was made by Gurney and no

testimony was offered to that effect. The same is true of the statement in the majority Opinion, (R. 114), that Gurney had alleged that Enoch J. Price for the purpose of misleading Harlan T. Hyde stated in a letter to Hyde that it would be unnecessary for him to attend a stockholders' meeting. No such statement is in Gurney's affidavit and no proof to that effect was offered, the fact being that the letter was written by Mrs. Wheeler and no direction from Mr. Price was shown.)

(b) No Misconduct Authorizing Stockholder to File Petition.

Notwithstanding the plain words of the statute and the clear decisions above cited, counsel claim that this stockholder became entitled to act for the corporation because of default or neglect of the corporation. They seek to invoke the well established rule that where there is fraud or misconduct on the part of officers or directors in failing to take action that should be taken, the stockholders may, under certain conditions, bring suits or make defense that the corporation should have brought or made.

It is held in *Hawes* v. *Oakland*, 104 U. S. 450, syl. 1, 460, that the stockholder can act only where (1) there was some action or threatened action of the directors beyond their authority, or (2) there was such a fraudulent transaction completed or threatened by the directors as would result in serious injury to the company or stockholders, or (3) that the directors were acting in their own interests destructive of the rights of the stockholders, or (4) that the majority of stockholders were oppressively and illegally pursuing in the name of the company a course in violation of the rights of the other stockholders. It is also held that the plaintiff must make it appear that he had made an earnest effort to obtain redress at the hands of the directors.

Rule 23(b) of Rules of Civil Procedure and Rule 27 of Equity Rules lay down practically the same rules.

In the first place there is a failure to show that this stockholder made "earnest effort" to obtain redress. The only thing done was to hand an undated paper, (R. 75), to Mrs. Wheeler, Manager of the Company on January 6, 1943, demanding that the Company file a petition under Chapter X, saying that upon failure to advise the attorneys of the stockholders within three days of willingness to "forthwith" file such proceeding stockholders would take such steps as they deemed necessary and advisable for the institution of such proceeding. No one but the Board of Directors could pass upon the question and obviously there was no time for a meeting of the Board between Wednesday, January 6th, and Monday, the 11th, (when the petition was filed), especially considering that three members of the Board lived in Chicago or vicinity. Rule 23(b) of Rules of Civil Procedure provides that efforts of shareholders to secure action by directors be set forth.

There was really no claim of wrongful conduct but Mr. Gurney thought that the business should have been expanded, production engineers employed and machinery bought. (Par. 12 of Gurney's "Petition for Reorganization", R. 4. Gurney's Affidavit, R. 8. Gurney's testimony, R. 29-30.) The directors disagreed with Gurney. This, of course, was a matter of business judgment. Whether it would be profitable in the end for this small Company to go into debt to expand its plant and facilities for manufacturing was a doubtful question. It was and is common knowledge that it would have been, at the time this controversy arose, probably impossible to procure new machine tools and, if procured, they would have been at a very

high cost. Labor could not have been secured, especially the skilled labor required by this Company in the production of its precision products. How long the emergency would last no one knew and whether enough profit would be made to pay for the outlay for extension of the plant and business was entirely problematical. The chances were that the same thing would happen to this Company that happened to it at the close of the First World War, (when the Hydes and Gurneys were in control), that is, they evidently thought they were making large profits and bought machinery and equipment which was not needed when the War ended. (R. 65-7, 32). This left the Company in such shape that they were required to make the bond issue in question, in doing which they managed to get investors, mostly in the vicinity of Chicago, to put in their money. Now, these bondholders who risked so much and have sacrificed so much during twenty years are entitled to use their judgment in managing the Company instead of the judgment of stockholders who have only a very remote and speculative chance of ever getting anything from this Company.

Conduct that is considered inconsistent in situations of this sort must be something wrongful and deceptive. Here there was nothing wrongful in the inception or continuance of the relation which was created by the stockholders, including those who are now said to be complaining.

It was of course expected that the bondholders would run the business of the Company in their interest, if there was any divergence of interest. As a matter of fact there has been no divergence of interest, although there has been a difference of opinion as to the proper business course to pursue. The Court was called upon to determine as to business judgment in the affairs of the Company and asked to determine that the conduct of the Di-

rectors has been not only unwise but fraudulent. The important fact is that the bondholders, although they had been given full power and opportunity to do otherwise, held up and nursed along this sick corporation over a period of twenty years until the War gave a chance to make profits, thus keeping it intact so that if the stockholders thought it worth while they could redeem the property. That the bondholders did not choose to put this concern in further and overwhelming debt is hardly reason to believe that they were acting fraudulently or in bad faith.

To illustrate the good faith of the Directors and Committee: After the Company had begun to make a little money, instead of using it to pay overdue bond interest, upwards of $3,000.00 was used to buy bonds from discouraged bondholders, some as low as 10 cents and never exceeding 25 cents on the dollar, (R. 2, 7, 32). These bonds were canceled and thus the Company's bonded debt was reduced $16,600.00, which was distinctly for the benefit of the stockholders since it increased the possibility of their equity having some value. That money might have been paid to the Committee as interest on the bonds and the Committee could have purchased the bonds and held them, principal and interest, against the Company and its property.

Voting Trust is Valid.

A voting trust agreement giving the control of the company to bondholders in order to make the loan more secure and vest the management in hands satisfactory to the lenders, and for a term commensurate with the loan, is valid.

14 *Cor. Jur.*, 918, n. 9;
Warren v. *Pim.*, 66 N. J. Equity 353, 408;

The right to end the voting trust (entered into to give bondholders the control), is disputed by the trustees on behalf of the bondholders. This is not the place to consider that question. The facts involved have not been developed and submitted to the Court. The parties have allowed twenty years to pass without challenging the Voting Trust and we submit it cannot be considered and passed upon in this collateral way. The dissenting opinion of Judge Hicks makes this point clear. (R. 124).

As to Claim that Directors were Illegally Elected.

It appears that for many years James G. Gurney was representing his mother and father in the matter of this corporation and the minutes of earlier annual meetings show that he appeared for his mother. At the 1941 meeting he did not appear and therefore the record is silent as to notice to Stella Gurney. It is apparent that this is a very immaterial and harmless technical objection. It does not affect the fact that the five directors declared elected at that meeting became and acted as de facto directors. The situation at the 1942 annual meeting was similar. The same directors were declared elected and acted as such. After the 1941 meeting James G. Gurney attended a Directors' meeting on September 6, 1941, and took part in the meeting as admitted by him, (R. 12, 49). There is no claim that James G. Gurney and his father, James Gurney, Jr., were not notified of both annual meetings and the Secretary evidently assumed that the former would continue to act for his mother.

There was no secrecy as to these meetings. As we have shown above, the complaining stockholders were promptly notified of the holding and action of these meetings.

An irregularity, such as that no notice of stockholders'

meeting was given, cannot be questioned by one who knew the fact and acquiesced.

Clarke v. *Thomas*, 34 O. S. 46, syl. 3.

Since James G. Gurney knew of these meetings and the action taken thereat, it can be assumed that the father and mother for whom the son had been acting, also knew and acquiesced therein.

As to De Facto Directors.

It is well settled, (in Ohio at least), that persons who assume the duties of directors of a corporation and act as such under color of title are de facto directors and their acts are valid until their authority is directly attacked.

> "De Facto directors, generally speaking, are directors who lack the proper qualifications for office or who have been illegally elected but who hold office under color of an election; and, under the de facto doctrine, the acts of such directors within the scope of the authority of de jure directors are binding upon the corporation."
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> 1 Davis Ohio Corp. Law, p. 790, par. 10;
> *Ehrman* v. *Union Central Life Ins. Co.*, 35 O. S. (324), 339;
> *Clarke* v. *Thomas*, 34 O. S. 46, 58;
> *First Pres. Society* v. *First Pres. Society*, 25 O. S. (128), 133;
> *First Pres. Society* v. *Rogers*, 12 O. S. 248, 251.

Where trustees of a corporation were elected without the required notice being given, this was considered an "irregularity," but those elected became de facto trustees and "the informality could only have been taken advantage of by those having a better right (if there were such), during the current year for which they were elected."

First Pres. Society v. *First Pres. Society*, 25 O. S. (128), 133.

The title of trustees de facto of a corporation cannot be impeached collaterally,—can only be done in a direct proceeding by quo warranto.

First Pres. Society v. *Rogers*, 12 O. S. 248. 251.

Rate of Interest.

It is claimed that the rate of interest upon the bonds should be 4 per cent. The facts as to the interest have been given above. This should not be dignified as a real dispute. We submit that to change the rate stipulated in the Mortgage Deed of Trust and in the bonds some definite and positive written testimony is required.

Furthermore, any agreement to change the terms of the mortgage and bonds would be invalid unless upon adequate consideration. No consideration is alleged.

Such agreement is negatived by the fact that the Committee had no power under the Bondholders' Protective Agreement to make such change in the rate of interest. That Agreement (Exhibit No. 18, par. (18) R. 82), only authorized a lowering of the rate of interest to 6½ per cent and that only upon a refunding of the bond issue. That refunding never occurred and hence there was no authority in the Committee to change the interest rate.

Who can say that the 8 per cent interest was not required in order to sell the bonds and compensate the purchasers for the risk incurred?

The letters of E. J. Price (R. 65. 68), outlining freely and without reserve the whole picture of the careful preservation of this industrial invalid through the depression by the sincere efforts of the members of the Committee without assistance from those who now pretend to claim misconduct amounting to fraud and the contrasting pic-

ture of the grasping cupidity of this stockholder in seeking to gain an advantage over men from whom he has received honorable and generous treatment for almost twenty years show the real situation.

But if we should concede that there is a genuine dispute about the rate of interest we fail to see why that justifies saying that the Directors have acted in an inconsistent and fraudulent manner.

Rate of Interest Adjudicated.

We do not need to argue to this Court that a judgment of a state court has complete finality and that the federal courts recognize adjudications in state courts.

10 *Remington on Bankruptcy*, Sec. 4673.

In the foreclosure suit the amount due upon the mortgage was determined and a judgment rendered for the amount due. (R. 59). That adjudication cannot be disregarded or set aside unless directly attacked for fraud. No claim of fraud is made and could not be made in a collateral proceeding.

Adjudication by a state court in a prior proceeding is binding upon a bankruptcy court as to issues there determined.

In re Wickwire Spencer Steel Co., 12 Fed. Sup. 528, syl. 3;
10 *Remington on Bankruptcy* (5th Ed.) Sec. 4673.

There was a time and an opportunity to make this question. The petition in the foreclosure case claimed interest at 8 per cent and as we have seen, Gurney and his attor-

neys had notice of all the proceedings had and contemplated for five months prior to the judgment and during that time took no steps therein.

Laches of Complaining Stockholder.

As to the complaints and objections mentioned, there is the complete answer that these complaining parties had for a long time full knowledge of the facts and full opportunity to have obtained complete redress, if they were entitled to any redress, by direct proceedings.

In this collateral way they cannot complain and raise questions that should long ago have been raised directly, if ever raised. The laches of the stockholder began and continued for many years before the foreclosure proceeding. Now, suddenly to ask a Bankruptcy Court to determine and decree that a voting trust should be terminated, that directors were illegally elected and that a rate of interest should be changed—though adjudicated after ample notice—is contrary to orderly and proper procedure, as well as violative of the rights of the interested parties.

The dissenting opinion of Judge Hicks aptly summarizes this point. (R. 124).

(c) The Corporation had no Duty to File a Petition for Reorganization.

A derivative suit, that is, one to require some action to be taken on the part of the corporation that it should take, is merely one to take action that it is bound in law and duty to take. The thing here sought to be done is to reorganize a corporation.

The fourth proposition of the syllabus (as published in 142 Fed. 2nd, 404), with that part of the Opinion that sup-

ported it, (R. 118-9), is equivalent to holding that filing a petition to reorganize is a legal duty on the part of the company acting through its board of directors. But suppose the directors believe it unwise to reorganize or that there is no necessity therefor. Have they no discretion in the matter? Are they under a legal duty to file the petition if some stockholder thinks a reorganization should be had? There certainly is a discretion lodged somewhere to determine that question. Is it to be determined by a stockholder and not by the directors?

That entering into a reorganization is a matter of business judgment on the part of the directors is held in

In re South State St. Bld. Corp., (7th Cir.) 140 Fed. 2nd 363, syl. 1.

(d) Was the Corporation Guilty of Wrongful Conduct in not Making Defense in the Foreclosure Suit?

The majority opinion below seems to assume, (R. 121, 142 Fed. 2nd. 405, syl. 12), that there was a defense to the foreclosure suit which the corporation wrongfully failed to assert. The record shows no defense and none has been claimed, except that the interest rate on the bonds should have been lower than that contracted for in the bonds and mortgage. We have seen that the question of interest does not rate as a real dispute. There was talk at times in the past as to lower interest, (R. 31, 68), but the change was never made, although less than the stipulated rate was accepted for a time, first at one rate, then at another.

The statement is made in the opinion that Gurney for himself and others attempted to intervene in the foreclosure suit in the state court. (R. 113-4). This is incorrect. Although represented by an attorney on the ground,

(Mr. John M. Cole), with full knowledge for five months of the pendency and proceedings in that suit, no intervention and no demand on the corporation to defend was made. (R. 38-9). It is true that after the judgment and decree in that suit a motion was filed by Gurney to set aside the judgment, which motion was pending at the time of the hearing in the District Court. It is perhaps fair to say that since that hearing the motion was overruled in the Common Pleas Court of Clark County, Ohio, and no appeal therefrom, which does not appear in the record here.

Since this stockholder failed to act by intervening to defend or causing the corporation to defend after long opportunity to do so, it is too late to predicate a reorganization proceeding upon the supposed partial defense not made.

(e) The Corporation was not Solvent and Hence the Stockholder had no Interest in Reorganization.

It is of course well settled that where the corporation has not assets sufficient to pay its debts, the stockholders are not entitled to participate in a reorganization proceeding.

The only evidence below on this subject was the financial statements offered by Gurney, (R. 84-6), that the assets were not worth the liabilities by $51,608.08. The attempt to overcome this in part by claiming that too much interest had been charged, in the absence of evidence to support that claim, is not sufficient.

The operating statement, (R. 86-8), shows comparatively large operating profits for 1942 but the excess profits and other taxes are so large that only a small fraction of overdue interest could be paid from the net profit.

One very significant indication of insolvency is that bondholders were willing to sell their bonds at much less than par, although there was considerable overdue interest. Gurney testified, (R. 32), that he knew the Company had purchased bonds from bondholders at different times at 10, 15 or 20 cents on the dollar and as late as September, 1941, (R. 49), the directors took action authorizing the purchase of bonds, (Certificates of Deposit), at not more than 25 cents on the dollar. (At this meeting Gurney was present and he voted for such purchases, R. 32.) It is hardly possible that the war activity would so increase values as to make the assets of the Company worth the bonds and accumulated interest. It is common knowledge that at one stage such plants would have sold at inflated war prices but the sale has been delayed and the day for selling at such prices has gone by.

> "As some of the bondholders point out, the bulge of war earnings per se is unreliable for use as a norm unless history is to be ignored; and numerous other considerations, present here as in former periods, make them suspect as a standard for any reasonably likely future normal year. Among these are the great increase in taxes and in certain costs of operation and the decrease in water and truck competition."
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> *Institutional Investors* v. *C. M. St. P. & P. R. R.*, 318 U. S. 523, 543-4.

(f) No Reasonable Expectation that a Plan of Reorganization can be Effected.

It is of course obvious that no reorganization can be effected with all of the creditors opposed to it. The statute, (Ch. X. Section 179, U. S. C. Section 579), provides that two-thirds of each class of creditors must consent to a plan.

The only debts here, (except current taxes), are the bonds, all of which have been deposited with and transferred to the Bondholders' Protective Committee. It is plain that the holders of the bonds will be opposed to a reorganization proceeding in a Bankruptcy Court involving an expensive, delaying procedure, when their rights can be worked out in the pending foreclosure case.

The Committee now in fact owns the bonds and are opposing this proceeding. That Committee has the right to represent all the bonds unless the Court determines otherwise, but until the Court so determines the Committee has power to act.

In re Witherbee Corp., 88 Fed. 2nd 251, 255-6.
(Cert denied 301 U.S. 710; Rehearing denied 301 U.S. 71[illegible]

The court must be "satisfied" of good faith in filing the petition (Section 141). This means that the burden of satisfying the judge of the good faith is on the petitioner.

> 10 Remington on Bankruptcy (5th Ed.), Section 4457, p. 347, citing *In re Phila. Rapid Transit Co.*, 8 Fed. Sup. 51, syl. 2, affirmed 73 Fed. 2nd, 1022.

"Good faith" includes reasonable expectation that a plan can be effected. (Section 146(3)).

Petitioner has burden of proof of establishing good faith. *Manati Sugar Co.* v. *Mock*, 75 Fed. 2nd 284, syl. 2, 285.

The fact is there can be no difference of opinion. The bondholders, having held these bonds for over 22 years with little hope of realizing upon them, naturally will not join in any plan to modify their position. Any modification would be a relinquishment of an advantage in their present secured position. If any reasonable plan can be suggested, it can be worked out directly with the rep-

resentative of the bondholders, since, in order to be effective, it must be satisfactory to them, and hence no proceeding under Chapter X is necessary or called for. This situation shows the character of and motive behind the present proceeding. No plan has been suggested and counsel evidently do not want to meet this question by suggesting one.

Therefore, regardless of the immateriality of the charges of alleged wrongdoing and of the failure to prove same, this proceeding should not have been ordered sent back to the District Court to begin hearings and protracted proceedings when it is apparent no reorganization can be had.

Petition under Chapter X was dismissed as not filed in good faith because unreasonable to expect a plan of reorganization could be effected.

> *Fidelity Assurance Assn.* v. *Sims*, 318 U. S. 608.

A proposed reorganization must be the result of a reasonable plan which has reasonable prospects for success.

> *Tenn. Pub. Co.* v. *Am. Nat. Bank*, (6 C. C. A.) 81 Fed. 2nd. 463, Affirmed 299 U. S. 18.

A petition under Chapter X must show not only need for reorganization but also basis for expecting that reorganization can be effected.

> *Manati Sugar Co.* v. *Mock*, (2 C. C. A.) 75 Fed. 2nd, 284, syl. 3.

> "Where the object is reorganization, rather than liquidation, the petitioner should furnish some assurance, by pleading at least, that they reasonably expect a fairly general support for their proposed plan or promised plan. Other-

wise there would be little to be expected in the undertaking of assuming responsibility for a reorganization."

75 Fed. 2nd, 285.

"It does not appear that the petitioning debtor has any equity in the property, or that there is any reasonable probability that a successful reorganization can be had, or that anything can be accomplished by interfering with the rights of the holders of the mortgage or mortgage certificates to sell the property. *Manati Sugar Co.* v. *Mock*, (C. C. A.) 75 Fed. 2d. 284."

In re Francfair, Inc., 13 Fed. Sup. (513) 514.

Where a corporation had for years been engaged in losing financial struggle, had accumulated debts and been unable to raise needed capital, it was unreasonable to expect that reorganization could be effected.

Seaboard Terminals v. *West. Md. Ry.*, 108 Fed. 2nd 911, syl 13.

In re Reliable Estates, Inc., 33 Fed. Sup. 588, 589, is quite similar to the present case where it was held unreasonable to expect a plan to be effected.

(g) No Right to Displace or Modify Liens.

The right of creditors, particularly bondholders, to absolute priority over stockholders in a reorganization is clearly recognized and accrued interest on bonds has the same priority.

Con. Rock Prod. Co. v. *DuBois*, 312 U. S., 510, syl. 15-20.

Sec. & Ex. Com. v. *U. S. Realty Co.*, 310 U. S. 435, syl. 3, 4.

Marine Harbor Properties v. *Mfrs. Trust Co.*, 317 U. S. 78, syl. 5, 87 L. Ed. 73.

That no plan of reorganization is "fair and equitable" where the interests of stockholders are secured at the expense of creditors is settled in—

Case v. *Los Angeles Lumber Co.*, 308 U. S. 106.

(h) PRIOR PENDING PROCEEDING WILL BEST SUBSERVE INTERESTED PARTIES.

Section 146 of Chapter X (11 U. S. C. Section 546), paragraph (4), provides that a petition will not be deemed filed in good faith if a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such proceeding.

This provision of the statute was under consideration by this Court in a recent case and it was there held that when there is such prior pending proceeding it must appear, in order to justify petition for reorganization, that at least in some *substantial particular* the prior proceeding withholds or denies to creditors or stockholders benefits, advantages or protection which the bankruptcy act affords. It is specifically there held that it must be shown that interests of creditors and stockholders would be better subserved by a proceeding under the bankruptcy act than by a mortgage foreclosure.

Marine Harbor Properties v. *Manufacturers Trust Co.*, 317 U. S. 78, syl. 2, 4, 83-4.

See also *Fidelity Assurance Assn.* v. *Sims*, 318 U. S. 608, 619.

Where a prior proceeding is pending in a state court it must be proved that interests of creditors and stockholders would not be best served in state proceeding.

In re 325 *E.* 72*nd St.*, 53 Fed. Sup. 997, syl. 2.
In Re Reliable Estates, 33 Fed. Sup. 588.

It is conceded by the Court below that the party filing the petition while a prior proceeding is pending in a state court has the burden of showing that the interests of creditors and stockholders would be best served by a reorganization in bankruptcy. (R. 123, Syl. 17, 142 Fed. 2nd 405). Nowhere was such showing made in this case.

After reciting the allegations of the Petition and Affidavit and holding that the stockholder could file the Petition, the majority opinion, (R. 123) points out that a petition for corporate reorganization should be dismissed if it is unreasonable to expect that a reorganization can be effected or if a prior pending proceeding would best subserve the interests of the parties and further that the party filing the petition has the burden of showing that their interest would be best served by a reorganization in bankruptcy.

Recognizing that correct statement of the law there was nothing for the District Court to do but dismiss the petition, which action should now be affirmed, unless this Court is of the opinion that the Court of Appeals should have dismissed the appeal as asked for by appellees.

We call attention to the clear and concise dissenting opinion of Judge Hicks holding that Chapter X does not contemplate or provide for the proceeding below. We note that Judge Hicks holds that "the appeal should be dismissed". (R. 124)

The opinion of Judge Nevin of the District Court (R. 90), included a complete review of the case and an appropriate finding upon the facts and law.

The observation of Chief Justice Hughes in *Tenn. Pub. Co.* v. *Am. Nat. Bank*, 299 U. S. 22, is here very apt to the

effect that "the District Court is not bound to clog its docket with visionary or impractical schemes for reorganization."

We submit that the petition for certiorari should be granted and the judgment of the Circuit Court of Appeals reversed.

Respectfully submitted,

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